



Guidelines for Establishing a Local Business Loan Guarantee Program Secured by Bank Deposits

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Introduction

The establishment of a loan guarantee fund is a proven economic development tool. It enables credit worthy business borrowers to obtain bank loans for economically desirable projects when banks may be hesitant to loan due to gaps normal loan qualifications, such as collateral requirements.

Ideally a well-established guarantee program can multiply its fund balance by guaranteeing more than the actual amount of capital in the fund. However, local startup funds may not have the convincing track record necessary to allow banks to accept leveraging of the fund's capital.

A technique to induce banks to accept loan guarantees is to deposit amounts in the lending banks equal to the loan guarantees.

Following is an outline of the suggested procedure to establish a local business loan guarantee program secured by bank deposits.

Guidelines

Bank Arrangements: Before guaranteeing a loan a participating bank will:

1. Agree to secure the guaranteed portion of the loan by a deposit equal to the amount of the guarantee divided into equal certificates of deposit [CD] for each year of the guarantee term.
2. Agree to release a CD back to the guarantee fund at each anniversary date of the loan.

3. Agree to a first-tier loan to the borrower structured with equal monthly principle and interest payments for at least the term of the guarantee.
4. Include a cross-default provision in the first-tier and guarantee loan documents.

Borrower Arrangements: To be eligible for a loan guarantee the borrower must:

1. Meet all program requirements and conditions.
2. Provide a minimum percentage of equity as determined by the fund's criteria.
3. Secure a loan commitment from a bank contingent on the guarantee.
4. Execute a reimbursement agreement providing for direct repayment to the fund in case of default and loan liquidation.
5. Provide the fund with a subordinated collateral position on all assets pledged to the bank.

Program Criteria and Administration: When establishing a loan guarantee fund the administering agency should:

1. Determine eligible uses for the funds.
2. Determine the maximum portion of the bank loan amount to be guaranteed such as 25% of the bank loan.
3. Establish minimum and maximum guarantee amounts.
4. Determine the maximum guarantee term, such as four years.
5. Establish an application process.
6. Establish a fee schedule.

Local business loan guarantee programs have been successful in encouraging and influencing bank involvement in economic development activity by following guidelines similar to these.

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